United States Court of Appeals

for the Second Circuit

AMICUS BRIEF

75-7203

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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ROBERT ABRAHAMSON and
MARJORIE ABRAHAMSON,

Plaintiffs-Appellants,

vs.

MALCOLM K. FLESCHNER, WILLIAM J. BECKER,
HAROLD B. EHRLICH, LEON POMERANCE,
FLESCHNER BECKER ASSOCIATES, and
HARRY GOODKIN & COMPANY,

Defendants-Appellees.

BRIEF OF INVESTMENT COUNSEL ASSOCIATION OF AMERICA, INC. AS *AMICUS CURIAE*, SUPPORTING APPELLEES' PETITION FOR REHEARING AND SUGGESTION FOR REHEARING IN BANC

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March 22, 1977

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FOR THE SECOND CIRCUIT

NO. 212 - SEPTEMBER TERM, 1975

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ROBERT ABRAHAMSON and MARJORIE ABRAHAMSON,

Plaintiffs-Appellants,

v.

MALCOLM K. FLESCHNER, WILLIAM J. BECKER, HAROLD B. EHRLICH, LEON POMERANCE, FLESCHNER BECKER ASSOCIATES and HARRY GOODKIN & COMPANY,

Defendants-Appellees.

- X

BRIEF OF INVESTMENT COUNSEL ASSOCIATION OF AMERICA, INC. AS AMICUS CURIAE, SUPPORTING APPELLEES' PETITION FOR REHEARING AND SUGGESTION FOR REHEARING IN BANC

The Investment Counsel Association of America, Inc. ("the Association") was organized in 1937 as an association of those investment advisers engaged in rendering investment counsel services to clients. The central purpose of the Association was to articulate professional standards for its members. The 70 member firms of the Association constitute virtually all of the

larger and many of the smaller firms registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940 who are independent of the banking and brokerage industries and render continuous portfolio supervision and advice to clients on the basis of their individual needs and circumstances.

The defendants in the above-entitled action are not, and are apparently ineligible to be, members of the Association and therefore the Association has no interest in the essentially private aspects of the dispute. Its concern is with the creation by the Court of a new undefined private cause of action against investment advisers.

The Investment Advisers Act of 1940 reflects careful Congressional balancing of the interests of the investment advisory industry and the interests of its clients. S. Rep. No. 1775, 76th Cong., 3d Sess. 20-21 (1940); 86 Cong. Rec. 9815 (1940) (Remarks of Rep. Wolverton). The panel's opinion here destroys that balance. In finding that clients of an adviser are an "especial class" (Cort v. Ash, 422 U.S. 66, 78 (1975)) who are the intended beneficiaries of the Advisers Act, it ignores the much more important, and complex, issue involved: substantial alteration of the pattern of regulation of an industry which, as recently as December of 1975, the Securities and Exchange Commission advised Congress "[can have] substantial impact . . . on both the economy and the public investor. . ." (Statement of the Securities and

Exchange Commission in support of Proposed Amendments to the Investment Advisers Act of 1940, transmitted to Congress by Chairman Hills in December, 1975.) For 37 years, an unrestricted private right of action has not been a part of that pattern of regulation. During that period Congress has three times (1960, 1970, 1975) re-examined the regulatory scheme and has simply not articulated such a right. But the panel, in its decision chooses to "imply" that type of right.

A. It Was Fundamental Error to Fail to Consider the Implications of Section 206's Inclusion of "Prospective Clients"

We believe that the majority has rested its opinion on a fundamental error - the conclusion that:

> "Under Section 206, the plaintiff class is limited to the investment adviser's own clients." (Slip Op. at 6239)

This is simply not so. Section 206 of the Act plainly states that it extends to "any client or prospective client." Section 206 (1) and (2). (Indeed, Section 206(4) is even less specific as to persons protected: it makes it unlawful for an adviser "to engage in any act, practice or course of business which is fraudulent, deceptive or manipulative.") It was this fundamental error which enabled the majority to avoid the Supreme Court's warning not to imply private rights of action where the plaintiff class would include:

> "a putative plaintiff, who neither purchases nor sells securities but sues instead for intangible economic injury such as loss of a non-contractual opportunity to buy or sell . . . seeking a largely conjectural and speculative recovery in which the number of shares involved will depend on the plaintiff's subjective hypothesis."

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 734-735 (1975). The "prospective client" of Section 206 is the "Blue Chip Man" -- one of the

> "bystanders to the securities marketing process [who] could await developments on the sidelines without risk, claiming that inaccuracies in disclosure caused nonselling in a falling market and that unduly pessimistic predictions . . . followed by a rising market caused them to allow restrospectively golden opportunities to pass."

Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 747. Since "prospective clients" must be covered under Section 206, Blue Chip compels the conclusion that there can be no private right of action under Section 206.

B. The Only Private Right of Action Against Investment Advisers Is The Express, Carefully Circumscribed One Enacted by Congress.

If Congress had intended a general private right of action against investment advisers, why, in 1970, did it merely enact the limited right afforded by Section 36(b) of the Investment Company Act of 1940 and make no change in Section 206 of the Advisers Act? We believe, with Judge Gurfein, that in 1970 Congress reaffirmed its longstanding decision not to create a private right of action under Section 206.

In 1970 Congress did expressly consider and create a private right of action in this industry but it carefully circumscribed that right. (Investment Company Act of 1940, § 36(b)). In suits relating to mutual fund advisory fees, Congress (1) placed the burden of proof of breach of fiduciary duty on the plaintiff (§ 36(b)(1)); (2) provided that action by the board and shareholders of the investment company (the client) is to be given such consideration by the court as is deemed appropriate under all the circumstances (§ 36(b)(2)); (3) required that no action be brought or maintained against any one other than the recipient of the advisory fee and that no damages or other relief be granted against any person other than the recipient; (4) provided that no award of damages shall be recoverable for any period prior to one year before the action was instituted and (5) limited the award of damages to "actual damages resulting from the breach of fiduciary duty", in no event, to exceed the amount of compensation or payment received from the client (§ 36(b)(3)). Thus, in creating a private right of action for the group of clients which has the broadest public involvement -- an investment company -- Congress once again balanced industry need with client interest and circumscribed the private right. It would be anomalous for the courts to afford private clients greater protection through an implied right of action than that which Congress afforded to the thousands of public shareholders of mutual funds.

C. Since Congress Has Not Given "Substantial Support" for a Private Right of Action, This Court Should Not Create One.

In attempting to provide a remedy in this case the court has decided what, in other contexts, will become immensely complex factual and legal questions of causation, reliance, materiality and damages. From the narrow context of this case springs civil liability, without limit, under Section 206. We submit that, properly, the creation of such a right must be viewed in a broader context and that, in that context, the court must follow the admonition of the Supreme Court:

> "We would be unwilling to bring about this result, absent substantial support in the legislative history, and there is none."

Ernst & Ernst v. Hochfelder, ___ U.S. ___, 96 S. Ct. 1375, 1389 (1976). So here, given the constant Congressional recognition of the need to balance industry interest with client interest, given the careful Congressional circumscription of the only express right of action against investment advisers, given the fact that the Advisers Act (unlike any other Securities Act) contains no provision for damages, given the inevitable flood of cases which, under the rubric of "fraud" will inevitably challenge the judgments of investment advisers, with the benefit of hindsight, and given the importance of this industry to the national economy, unless "substantial support" is found in the legislative history (and we do not find it), the court should not find a private right of action. (See, SIPC v. Barbour, 421 U.S. 412 (1975)).

If a private right of action is an appropriate remedy in this industry, Congress, not the courts, should create it.

For the foregoing reason, we support Appellees' Petition.

March 22, 1977

Respectfully submitted,

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